

## Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-10 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03

SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07

CEA-01 IGA-02 MMO-01 L-03 /094 W

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R 172206Z FEB 78

FM AMEMBASSY LIMA

TO SECSTATE WASHDC 8807

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 1513

E.O. 11652: GDS

TAGS: ECRP, EGEN, EFIN, EALR, PE

SUBJECT: PROJECTED GOP CENTRAL GOVERNMENT FISCAL OPERATIONS  
FOR 1978

REF: (A) LIMA 1190, (B) LIMA 0001, (C) LIMA 0473, (D) LIMA 1347,  
(E) CERP 0200

1. SUMMARY: GOP DOCUMENT RECENTLY PRESENTED TO FOREIGN BANKERS (REF A) OFFERS BEST AVAILABLE INSIGHTS INTO LIKELY GOP FISCAL OPERATIONS IN 1978. NEWLY AVAILABLE DATA SUGGEST THAT 1978 IS GOING TO BE A YEAR OF FISCAL AUSTERITY WITH RELATIVELY LOW GROWTH OF EXPENDITURES AND HIGH GROWTH OF REVENUES. SUBSTANTIAL DEBT SERVICE IS A MAJOR ELEMENT AFFECTING EXPENDITURES. WE STILL HAVE SEVERAL QUESTIONS -- INCLUDING PROJECTED 57 PERCENT GROWTH IN TAX REVENUES. SINCE WE OBTAINED DOCUMENT ON CONFIDENTIAL BASIS AND BECAUSE OF GOP SENSITIVITY RE DISCUSSION OF BUDGET, WE HAVE BEEN UNABLE TO RESOLVE THESE QUESTIONS WITH GOP, BUT EXPECT ANSWERS WILL COME OUT OF CURRENT IMF/GOP CONSULTATIONS. END SUMMARY.

2. OUR REVIEW OF THE GOP'S 1978 CENTRAL GOVERNMENT BUDGET IN EARLY JANUARY CONVINCED US THAT THE PUBLISHED BUDGET (REF B) WAS AT BEST AN INCOMPLETE GUIDE TO PROBABLE  
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GOP 1978 FISCAL OPERATIONS. FOR EXAMPLE, THE 289.7 BILLION SOLES EXPENDITURE LEVEL (ALSO EQUALS REVENUE) WAS FAR LESS THAN THE 321.2 BILLION STATED IN A CONFIDENTIAL DOCUMENT GIVEN BY GOP TO FOREIGN BANKERS IN NOVEMBER 1977. THE JANUARY 13, 1978 PUBLIC PRESENTATION OF PERU'S MINISTER OF ECONOMY AND FINANCE DID NOT RESOLVE OUR DOUBTS BECAUSE HE MERELY PRESENTED AN ABBREVIATED GLOBAL BREAKDOWN OF THE 1978 BUDGET DECREE ALONG

WITH ADDITIONAL STATEMENTS INDICATING THAT THE CENTRAL GOVERNMENT HAD EXPERIENCED A 2,832 MILLION SOLES OVERRUN ON THE 1978 FISCAL WAGE BILL AND AN 11,337 MILLION SOLES OVERRUN ON FOOD PRODUCT SUBSIDIES WHICH WERE NOT INCLUDED IN THE BUDGET LAW (REF C). UNTIL QUITE RECENTLY, THEN, WE HAVE NOT FELT THAT WE HAD EVEN A REASONABLY CLEAR INSIGHT INTO GOP 1978 FISCAL OPERATIONS.

3. GOP JANUARY DOCUMENT. FORTUNATELY THE PERUVIAN MINISTRY OF ECONOMY AND FINANCE DOCUMENT ENTITLED "THE OCTOBER 1977-DECEMBER 1979 PROGRAM AND ITS IMPLEMENTATION UP TO DATE" (HEREINAFTER CITED AS GOP JANUARY DOCUMENT WHICH WE OBTAINED ON CONFIDENTIAL BASIS FROM PRIVATE SOURCE - REF A) CONTAINS USEFUL TABLES ON CENTRAL GOVERNMENT FISCAL OPERATIONS FOR THE PERIOD 1974-1977 AND PROJECTED FOR 1978 AS WELL AS NUMEROUS COMMENTS REFERRING TO 1978 FISCAL OPERATIONS. OUR EVALUATION GOP COMPLIANCE IMF TARGETS ALSO BASED ON THIS DOCUMENT (REF A). A COPY OF THE GOP JANUARY DOCUMENT WAS FURNISHED TO THE DEPARTMENT (ARA/AND).

4. THE GOP JANUARY DOCUMENT STATES (PAGE 13) THAT THE FIGURES FOR 1978 FISCAL OPERATIONS HAVE BEEN ADJUSTED TO ACCOUNT FOR (1) THE INCREASED EXPENDITURES FOR SUBSIDIES AND WAGES DECREED SUBSEQUENT TO THE ANACTMENT OF THE 1978 BUDGET LAW, (2) CONSIDERATION OF AN EXCHANGE RATE OF 130 SOLES TO THE U.S. DOLLAR INSTEAD OF 110 SOLES CALCULATED IN THE 1978

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BUDGET LAW, AND (3) CONSIDERATION OF EXPENDITURES NOT INCLUDED IN THE PUBLISHED BUDGET LAW. A BASIC SUMMARY TABLE UTILIZING PRESENTATION OF THE JANUARY DOCUMENT IS AS FOLLOWS, WITH THE 1978 BUDGET LAW SHOWN IN COLUMN A, THE JANUARY DOCUMENT PROJECTION SHOWN IN COLUMN B AND ALL DATA IN BILLIONS OF SOLES:

|                            | A         | B         |
|----------------------------|-----------|-----------|
| A. CURRENT REVENUES        | 226.2     | 242.6     |
| B. CURRENT EXPENDITURES    | 183.4     | 205.8     |
| C. CURRENT ACCOUNT SURPLUS | PLUS 42.9 | PLUS 36.8 |
| D. CAPITAL EXPENDITURES    | 45.2      | 45.9      |
| E. ECONOMIC DEFICIT        | - 2.3     | - 9.1     |
| F. OTHER EXPENDITURES      | --        | 39.5      |
| G. OVERALL DEFICIT         | - 2.3     | - 48.6    |

|                   |      |      |
|-------------------|------|------|
| H. FINANCING      | 2.3  | 48.6 |
| (1) EXTERNAL, NET | 32.4 | 1.1  |
| DISBURSEMENT      | 14.9 | 57.2 |
| AMORTIZATION      | 47.4 | 56.0 |
| (2) INTERNAL, NET | 34.8 | 47.5 |
| DISBURSEMENT      | 48.6 | N.A. |
| AMORTIZATION      | 13.8 | 13.8 |

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|                       |       |       |
|-----------------------|-------|-------|
| I. TORAL EXPENDITURES | 289.7 | 361.0 |
| J. TOTAL REVENUES     | 289.7 | 361.0 |

THE JANUARY DOCUMENT DOES NOT REVEAL GROSS DISBURSEMENT (I.E. UTILIZATION) OF DOMESTIC CREDIT. THE NET UTILIZATION OF INTERNAL CREDIT IN 1978 IS STATED AS 47,489 MILLION SOLES COMPOSED OF NET UTILIZATION OF BANKING SYSTEM CREDIT AT 34,800 MILLION, NET UTILIZATION OF BONDS AT 7,000 MILLION, AND NET UTILIZATION OF "OTHER" AT 5,689 MILLION SOLES. THE JANUARY DOCUMENT STATES AMORTIZATION OF INTERNAL CREDIT AT 13,777 MILLION SOLES: THEREFORE GROSS UTILIZATION OF INTERNAL CREDIT MUST BE 61,266 MILLION SOLES.

5. INTERESTINGLY, THE FORMAT USED BY THE GOP IN THE JANUARY DOCUMENT EMPLOYS AN ITEM ENTITLED "OTHER EXPENDITURES." THIS IS THE FIRST TIME SUCH AN ITEM HAS APPEARED. THE DETAIL IN THE JANUARY DOCUMENT UNDER DISBURSEMENT OF 1978 EXTERNAL CREDIT CONTAINS TWO ITEMS: "PROJECTS" (WITH 17,628 MILLION SOLES) AND "OTHER" (WITH 39,520 MILLION). COMPARISON OF IMF DATA (CONTAINED IN EBS/77/393 PAGE 28) WITH GOP JANUARY DOCUMENT PRESENTATION FOR THE YEARS 1975-1977 INDICATES THAT THE ITEM NOTED AS OTHER EXPENDITURES IS INCLUDED BY IMF AS CURRENT EXPENDITURES AND RAISES POSSIBILITY THAT THIS ITEM COULD INCLUDE THE EXTERNALLY-FINANCED PORTION OF MILITARY OUTLAYS (REF D). THE GOP JANUARY DOCUMENT REFERS TO THE "OTHER EXPENDITURES" ON PAGE 13 AS "OTHER EXPENDITURES NOT BUDGETED, ENTIRELY FINANCED BY EXTERNAL RESOURCES."

6. THE GOP JANUARY DOCUMENT PRESENTS THE USUAL BASIC DATA FORMAT FOR CURRENT AND CAPITAL EXPENDITURES. DATA FOR 1977 ARE PRELIMINARY, AND DATA FOR 1978 ARE PROJECTIONS. FOLLOWING IMF

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METHODOLOGY WE INCLUDE "OTHER EXPENDITURES" AS A LINE-ITEM IN CURRENT EXPENDITURES. THE LAST TWO COLUMNS ARE PERCENT CHANGE (FROM PRIOR YEAR) FOR 1977 (A) AND 1978 (B). ALL DATA ARE IN BILLIONS OF SOLES:

|                         | 1977   | 1978   | (A)   | (B)   |
|-------------------------|--------|--------|-------|-------|
| A. CURRENT EXPENDITURE  | 184.0  | 245.3  | 18.1  | 33.3  |
| WAGES AND SALARIES      | 70.3   | 88.0   | 36.5  | 25.0  |
| GOODS AND SERVICES      | 18.6   | 20.4   | 2.2   | 9.6   |
| TRANSFERS               | 28.2   | 50.1   | 9.4   | 77.9  |
| INTEREST PAYMENTS       | 29.1   | 47.3   | 121.0 | 62.5  |
| --INTERNAL DEBT         | (13.5) | (16.5) | 145.6 | 21.8  |
| --EXTERNAL DEBT         | (15.6) | (30.9) | 103.4 | 97.7  |
| OTHER EXPENDITURES      | 37.7   | 39.5   | 168.4 | 4.7   |
| B. CAPITAL EXPENDITURES | 36.8   | 45.9   | -0.7  | 24.6  |
| GROSS CAPITAL FORMATION | 24.4   | 35.5   | 23.0  | 45.5  |
| CAPITAL TRANSFERS       | 12.2   | 10.4   | -26.7 | -15.4 |
| OTHER                   | 0.2    | --     | --    | --    |
| C. AMORTIZATION         | 33.9   | 69.8   | 110.4 | 106.0 |
| INTERNAL DEBT           | 10.9   | 13.8   | 39.0  | 26.9  |
| EXTERNAL DEBT           | 23.0   | 56.0   | 177.7 | 143.4 |

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|----------|-------|-------|------|------|
| D. TOTAL | 254.7 | 361.0 | 44.8 | 41.7 |
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INR-10 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03  
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TOTAL EXPENDITURES INCREASE FROM 1977 BY 41.7 PERCENT. THE TOTAL FOR DEBT SERVICE AMOUNTS TO 117.1 BILLION SOLES IN 1978 AS COMPARED WITH 63.0 BILLION IN 1977, AN INCREASE OF 85.9 PERCENT. ALL OTHER CURRENT AND CAPITAL EXPENDITURES INCREASE BY 27.2 PERCENT -- FROM 191.7 BILLION TO 243.9 BILLION SOLES. THE MOST MYSTERIOUS REMAINING ITEM IS CURRENT TRANSFERS. ACCORDING TO THE 1978 BUDGET LAW THIS ITEM IS 14.2 BILLION SOLES; PER THE GOP JANUARY DOCUMENT IT IS 50.1 BILLION SOLES. WE HAVE THUS FAR BEEN UNABLE TO TRACE MORE THAN 12 BILLION OF THIS DIFFERENCE, WHICH CAN BE CHARGED TO OVERRUNS IN PUBLIC SECTOR WAGE INCREASES AND FOOD SUBSIDIES.

7. THE REVENUE ESTIMATES (1977) AND PROJECTIONS (1978) CONTAINED IN GOP JANUARY DOCUMENT ARE AS FOLLOWS IN BILLIONS OF SOLES. UTILIZATION OF CREDIT IS STATED ON GROSS BASIS. COLUMNS A AND B REPRESENT PERCENTAGE CHANGES (FROM PRIOR YEAR) FOR 1977 AND 1978 RESPECTIVELY:

|                  | 1977  | 1978  | (A)  | (B)  |
|------------------|-------|-------|------|------|
| CURRENT REVENUES | 154.1 | 242.6 | 38.3 | 57.4 |
| TAX REVENUES     | 145.6 | 229.2 | 43.0 | 57.5 |

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|                  |      |      |      |      |
|------------------|------|------|------|------|
| NON-TAX REVENUES | 14.9 | 20.2 | 18.1 | 35.6 |
|------------------|------|------|------|------|

DOCUMENTS (NOT CASH) -6.4 -6.8 112.3 6.8

#### UTILIZATION OF CREDIT

EXTERNAL 46.9 57.1 96.2 21.7

PROJECTS (9.2) (17.6) 3.5 91.5

OTHER (37.7) (39.5) 168.4 4.7

INTERNAL 53.7 61.3 32.1 14.2

TOTAL REVENUE 254.7 361.0 44.8 41.7

THESE DATA INDICATE THAT CURRENT REVENUES (WHICH ARE PRINCIPALLY TAX REVENUES) ARE PROJECTED TO INCREASE BY 57 PERCENT IN 1978. THE JANUARY DOCUMENT STATES THAT THE 57 PERCENT INCREASE IN CURRENT REVENUES IS DERIVED FROM NEW FISCAL MEASURES, MORE EFFICIENT TAX ADMINISTRATION, AND GREATER INCOME FROM TAXES RELATED TO FOREIGN TRADE. THE JANUARY DOCUMENT PROVIDES THE FOLLOWING ESTIMATE FOR REVENUES FROM NEW FISCAL MEASURES (STATED IN BILLIONS OF SOLES):

INCREASE IN TAXES ON NON-GASOLINE  
PETROLEUM DERIVATIVES (DL 22071) 6.1

INCREASE IN TAX BASE ON IMPORTED  
GOODS AND SERVICES (DL 22044) 1.2

SCALE MODIFICATION AND INCREASE IN  
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RATES IN TAXES ON BUSINESS-OWNED  
REAL ESTATE (DL 22045) 0.5

INCREASE OF TAX BASE ON REVALUATION OF  
BUSINESS-OWNED REAL ESTATE 1.2

REVALUATION OF FIXED ASSETS ACQUIRED UP  
TO END OF 1977 AND 4 PERCENT TAX ON  
SURPLUS 1.2

ANNULMENT OF SOME EXEMPTIONS ON  
BUSINESS-OWNED REAL ESTATE  
TAX AND SALARIES 1.2

ADVANCE PAYMENT OF TAXES ON GOODS AND  
SERVICES -- DUE IN JANUARY 1978 2.0

INCREASE IN TAX ON COCA LEAVES

(DL 22046) 0.2

13.6

APART FROM THIS 13.6 BILLION SOLES INCREASE FROM TAX RATE AND BASE MODIFICATION, A 5.0 BILLION INCREASE IS PROJECTED AS RESULTING FROM IMPROVED TAX ADMINISTRATION.

8. INCLUSIVE OF THESE FISCAL MEASURES, THE SIX MAJOR CATEGORIES OF TAX REVENUES ARE PROJECTED TO INCREASE BY THE FOLLOWING PERCENTAGES IN 1978: INCOME TAXES (50.1); PROPERTY TAXES (49.1); IMPORT DUTIES (50.2); EXPORT DUTIES (94.0); PROJECTION AND EXCISE TAXES (51.1); AND OTHER (131.3). THE PROJECTED 1978. REVENUES FOR THESE MAJOR TAX CATEGORIES ARE AS FOLLOWS, IN BILLIONS OF SOLES: INCOME TAXES (45.7); PROPERTY TAXES (13.4); IMPORT DUTIES (29.5); EXPORT DUTIES (31.2); PRODUCTION AND EXCISE TAXES (100.9); AND OTHER (8.5). EXCLUSIVE  
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OF TAX MEASURES NOTED PARA 7 ABOVE AND OF TAXES ON FOREIGN TRADE (IMPORT AND EXPORT DUTIES), 1977 TAX REVENUES AMOUNTED TO 109.8 BILLION SOLES AND ARE PROJECTED TO INCREASE TO 151.1 BILLION SOLES IN 1978 -- AN INCREASE OF 37.6 PERCENT.

9. COMMENT: A. WE HAVE SEVERAL QUESTIONS REMAINING IN REGARD TO GOP 1978 FISCAL OPERATIONS: (1) THE TRUE NATURE OF "OTHER EXPENDITURES" DISCUSSED IN PARA 5; (2) WHETHER 34.8 BILLION SOLES IS MAXIMUM PERMISSIBLE USE IN 1978 BY CENTRAL GOVERNMENT OF NET BANKING SYSTEM CREDIT ACCORDING TO IMF AGREEMENT (GO JANUARY DOCUMENT ASSERTS THIS ON PAGE 17 BUT WE BELIEVE VARIOUS COMBINATIONS OF FISCAL TRANSFERS TO REST OF PUBLIC SECTOR AND NET USE BY CENTRAL GOVERNMENT OF BANKING SYSTEM CREDIT ARE COMPATIBLE WITH IMF AGREEMENT LIMIT OF 50.5 BILLION NET DOMESTIC CREDIT TO PUBLIC SECTOR); (3) WHETHER THE 25 PERCENT INCREASE IN WAGE BILL INCLUDES OR EXCLUDES IMPACT FURTHER PUBLIC SECTOR WAGE INCREASE IN 1978; AND, PERHAPS MOST IMPORTANT, (4) PRECISELY HOW THE 57 PERCENT REVENUE INCREASE WAS ESTIMATED.

B. WE HAVE NOT SOUGHT TO RESOLVE THESE QUESTIONS DIRECTLY WITH GOP BECAUSE (1) WE OBTAINED THE KEY JANUARY DOCUMENT FROM A CONFIDENTIAL, NON-OFFICIAL SOURCE; (2) THE GOP HAS BEEN RELUCTANT TO DISCUSS BUDGET FIGURES WITH US IN DETAIL; AND (3) WE FEEL IT INAPPROPRIATE TO PRESS THIS MATTER WHILE THE GOP IS

CONSULTING WITH PRIVATE BANKS IN NEW YORK AND IMF TEAMS  
HERE. IN ANY EVENT, THE IMF REVIEW HERE, OR  
LATER IN WASHINGTON SHOULD CLARIFY THESE QUESTIONS.  
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## Message Attributes

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**Type:** TE  
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**Review Markings:**  
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